

Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of)	
)	
Requests for Review of)	
Decisions of the)	
Universal Service Administrator by)	
)	
Net56, Inc.)	File Nos. SLD-552545, <i>et al.</i>
Palatine, IL)	
)	
Schools and Libraries Universal Service)	CC Docket No. 02-6
Support Mechanism)	

ORDER

Adopted: November 7, 2012

Released: November 7, 2012

By the Chief, Telecommunications Access Policy Division, Wireline Competition Bureau:

1. Consistent with precedent,¹ we grant three requests from Net56, Inc. (Net56) seeking review of decisions by the Universal Service Administrative Company (USAC) under the E-rate program (more formally known as the schools and libraries universal service support program) to deny or rescind funding from Harrison School District 36's (Harrison) applications for funding years 2007, 2008, and 2009.² Specifically, for funding year 2007, USAC sought recovery of funds already disbursed to Harrison

¹ See, e.g., *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 9029-9030, paras. 480-81 (1997) (*Universal Service Order*) (finding that while price should be the primary factor in selecting a bid, schools and libraries have maximum flexibility to take service quality into account and choose the offering that meets their needs most effectively and efficiently. Applicants may consider "prior experience, past performance, personnel qualifications, including technical excellence, management capability, including schedule compliance, and environmental objectives" to determine whether an offering is cost effective); *Request for Review by Ysleta Independent School District of the Decision of the Universal Service Administrator*, CC Docket Nos. 96-45, 97-21, Order, 18 FCC Rcd 26407, 26431 para. 53 (2003) (*Ysleta*) ("The Commission has determined that seeking competitive bids for eligible services is the most efficient means for ensuring that eligible schools and libraries are fully informed of their choices and are most likely to receive cost-effective services"); *Request for Review by Macomb Intermediate School District Technology Consortium of the Decision of the Universal Service Administrator*, CC Docket No. 02-6, Order, 22 FCC Rcd 8771, 8772 (2007) (*Macomb*) (applicants must select the most cost effective service offering). See also *Requests for Review by Allendale County School District, et. al. of the Decision of the Universal Service Administrator*, CC Docket No. 02-6, Order, 26 FCC Rcd 6109 (Wireline Comp. Bur. 2011) (*Allendale*). In *Allendale*, the Wireline Competition Bureau found that three petitioners had only one bid for E-rate supported services that was responsive to their FCC Form 470 postings. "As a result, in each of these three instances, the responsive bid necessarily offered the lowest price." *Allendale*, 26 FCC Rcd at 6116, para. 10.

² See Appendix. Section 54.719(c) of the Commission's rules provides that any person aggrieved by an action taken by a division of USAC may seek review from the Commission. 47 C.F.R. § 54.719(c) (2012).

for services provided by Net56. For funding years 2008 and 2009, USAC denied funds for Harrison's E-rate applications.

2. For all three funding years, USAC found that in selecting Net56 to provide Internet access, wide area network (WAN), firewall services, and web and email hosting services, Harrison violated multiple Commission rules. Specifically, with respect to Harrison's funding requests for Internet access, USAC found that Harrison did not have signed contracts in place prior to filing its FCC Form 471 that it included ineligible products and services and did not cost allocate them, and that it failed to pay its discounted share for eligible services and therefore effectively and improperly accepted free services.⁶ USAC made similar findings for Harrison's funding requests for WAN, firewall services, and web and email hosting services, and also found that Harrison failed to select cost-effective eligible services.⁷

3. Based on our review of the record,⁸ we find that Harrison did have signed contracts in place prior to filing its FCC Form 471. We also find that Harrison did cost allocate ineligible from eligible services and did pay its discounted share for eligible services, and therefore did not accept free eligible services. Finally, we find that Net56 adequately demonstrated that the costs for the products and services in the funding requests were reasonable based on Harrison's circumstances and were therefore cost effective under Commission rules. We therefore grant and remand Net56's requests to the extent provided below.

³ See Letter from USAC, Schools and Libraries Division, to Shirley Peterson, Harrison School District 36, at 4 (dated May 6, 2011) (regarding Harrison's funding year (FY) 2007 FCC Form 471 application number 552545, funding request numbers (FRNs) 1531745, 1531757, 1531771, 1531783, 1531795) (Harrison FY 2007 Commitment Adjustment Letter).

⁴ See Letter from USAC, Schools and Libraries Division, to Jill Gildea, Harrison School District 36 (dated Feb. 24, 2010) (regarding Harrison's FY 2008 FCC Form 471 application number 634059, FRNs 1753187, 1753238, 1753268, 1753317) (Harrison FY 2008 Funding Commitment Decision Letter (FCDL)) (denying funds for FY 2008); Letter from USAC, Schools and Libraries Division, to Jill Gildea, Harrison School District 36 (dated Mar. 26, 2010) (regarding Harrison FY 2008 FCC Form 471 application number 634059, FRNs 1753187, 1753238, 1753268, 1753317) (FY 2008 Further Explanation of Administrator's Funding Decision); Letter from USAC, Schools and Libraries Division, to Jill Gildea, Harrison School District 36 (dated Apr. 13, 2010) (regarding Harrison's FY 2009 FCC Form 471 application number 678493, FRNs 1852702, 1852749, 1852785, 1852800) (Harrison FY 2009 FCDL) (denying funds for FY 2009); Letter from USAC, Schools and Libraries Division, to Jill Gildea, Harrison School District 36 (regarding Harrison FY 2009 FCC Form 471 application number 678493, FRNs 1852702, 1852749, 1852785, 1852800) (FY 2009 Further Explanation of Administrator's Funding Decision). Subsequently, USAC also denied Net56's appeals of Harrison's funding year 2008 and 2009 funding denials. See Letter from USAC, Schools and Libraries Division, to Paul B. Hudson, Counsel to Net56, Inc. (dated Aug. 4, 2010) (Administrator's Decision on Appeal – Funding Year 2008-2009); Letter from USAC, Schools and Libraries Division, to Paul B. Hudson, Counsel to Net56, Inc. (dated Oct. 26, 2010) (Administrator's Decision on Appeal – Funding Year 2009-2010).

⁵ See generally *supra* nn. 3-4.

⁶ See Harrison FY 2007 Commitment Adjustment Letter at 4; FY 2008 Further Explanation of Administrator's Funding Decision at 6-9; FY 2009 Further Explanation of Administrator's Funding Decision at 6-9.

⁷ See Harrison FY 2007 Commitment Adjustment Letter at 6-13; FY 2008 Further Explanation of Administrator's Funding Decision at 1-5; FY 2009 Further Explanation of Administrator's Funding Decision at 1-5.

⁸ The Bureau must conduct a *de novo* review of requests for review of decisions issued by USAC. 47 C.F.R. § 54.723 (2012).

⁹ See 47 C.F.R. §§ 54.503(c)(2)(vii), 54.511(a) (2012). See also 47 C.F.R. §§ 54.504(c)(1)(xi), 54.511 (2007). See also *supra* n. 1. In this order, we describe the requirements of the E-rate program as they currently exist, but

(continued...)

4. Under the Commission's rules, applicants must seek competitive bids for all services eligible for support,¹⁰ submit an FCC Form 470 for posting on USAC's website,¹¹ and wait 28 days before making any commitments with a service provider.¹² Applicants must also select a service provider using price as the primary factor.¹³ After selecting a service provider, applicants must enter into a contract prior to filing their FCC Forms 471 requesting support for eligible services.¹⁴ Applicants must also clearly allocate the costs of eligible and ineligible services.¹⁵

5. The record before us demonstrates that Harrison complied with these rules for all three funding years and considered price as the primary factor when selecting Net56.¹⁶

6. In its decision to deny and rescind funding, USAC states that Harrison filed its FCC Form 471 and then signed a five-year contract with Net56.¹⁷ USAC also concludes that this contract failed to cost allocate eligible from ineligible services.¹⁸ It is uncontested that during USAC's special compliance review, Harrison had provided a five-year contract that included both eligible and non-eligible services

(Continued from previous page)

because the order involves applications from funding years 2007-2009, and the Commission has re-organized the E-rate rules since then, where the Commission's rules have changed, we also cite to the relevant rules as they existed during the relevant funding years.

¹⁰ See 47 C.F.R. § 54.503(a) – (b) (2012) (applicants “must conduct a fair and open competitive bidding process” and must “seek competitive bids . . . for all services eligible for support”). See also 47 C.F.R. § 54.504(a) (2007).

¹¹ See 47 C.F.R. § 54.503(c) (2012) (applicants “seeking to receive discounts for eligible services under this subpart, shall submit a completed FCC Form 470 to the Administrator to initiate the competitive bidding process”). See also 47 C.F.R. § 54.504(b) (2007). The rules also require USAC to post the FCC Forms 470 submitted by applicants on its website. See 47 C.F.R. § 54.503(c)(3) (2012). See also 47 C.F.R. § 54.504(b)(3) (2007).

¹² See 47 C.F.R. § 54.503(c)(4) (requiring that after an applicant's FCC Form 470 is posted on USAC's website, the applicant “wait at least four weeks from the date on which its description of services is posted on the Administrator's website before making commitments with the selected providers of services”). See also 47 C.F.R. § 54.504(b) (4) (2007).

¹³ See 47 C.F.R. § 54.511(a) (2012) (requiring that “in determining which service offering is the most cost-effective, entities may consider relevant factors other than the pre-discount prices submitted by providers, but price should be the primary factor considered”). See also 47 C.F.R. § 54.511(a) (2007).

¹⁴ See 47 C.F.R. § 54.504(a) (2012) (applicants “shall, upon signing a contract for eligible services, submit a completed FCC Form 471 to the Administrator”). See also 47 C.F.R. § 54.504(c) (2007).

¹⁵ See 47 C.F.R. § 54.504(e) (2012) (“A request for discounts for a product or service that includes both eligible and ineligible components must allocate the cost of the contract to eligible and ineligible components”). See also 47 C.F.R. § 54.504(g) (2007).

¹⁶ See 47 C.F.R. § 54.503 (2012) (requiring applicants to seek competitive bids to procure E-rate services and providing instruction on the protocol for the bidding process). See also 47 C.F.R. § 54.504 (2007); Letter from Jill Gildea, Harrison School District 36, to Gary Tarantino, USAC, Schools and Libraries Division (dated Apr. 29, 2009) (explaining that Net56 was the only bidder and explaining the selection criteria and competitive bidding process for Harrison); Email from Net56, Inc. to Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission (dated May 21, 2012).

¹⁷ See Harrison FY 2007 Commitment Adjustment Letter at 4, 6, 7, 8, 10, 12; FY 2008 Further Explanation of Administrator's Funding Decision at 6; FY 2009 Further Explanation of Administrator's Funding Decision at 6.

¹⁸ See FY 2008 Further Explanation of Administrator's Funding Decision at 6; FY 2009 Further Explanation of Administrator's Funding Decision at 6.

without cost allocation between such services.¹⁹ In its appeal, however, Net56 argues that it had submitted different contracts to USAC, but USAC reviewed the wrong document, and that the actual E-rate services contracts for all three funding years were one-year contracts signed in advance of Harrison's FCC Form 471 filings.²⁰ Net56 also argues that the E-rate contracts and documentation that it submitted to USAC did cost allocate ineligible from eligible services.²¹

7. We find that the record before us reflects that after selecting Net56, Harrison signed contracts with Net56 for all three funding years prior to filing its annual FCC Forms 471.²² In its appeal to the Commission of USAC's decisions to deny and rescind funding, Net56 submitted into the record the E-rate services contracts and documentation that listed costs associated with Internet access, wide area network services, firewall services, and web hosting and email services and also provided the cost of ineligible services.²³ Thus, based on the record before us, we conclude that Harrison and Net56 did have timely contracts in place that allocated costs for eligible and ineligible services.

8. The Commission's rules also require that applicants, after completing the competitive bidding process and receiving services, must pay their non-discount portion of the cost of goods and services to the service providers.²⁴ Here, USAC concluded that Harrison did not pay its share for services,²⁵ and consequently that Harrison accepted free eligible services.²⁶ Net56 disputes this finding and explains that if USAC had considered the correct E-rate contract and accompanying documentation, which showed the price allocations for eligible and ineligible services, it would have determined that Harrison did pay its share for eligible services.²⁷ Net56 explains that it used a financial company, American Capital Financial Services, Inc. ("ACFS"), to facilitate payments from Harrison to Net56 for E

¹⁹ See, e.g., Request for Review by Net56, Inc. of Decision of the Universal Service Administrator; Harrison School District 36, 2008 Funding Year, FRNs 1753187, 1753238, 1753268, 1753317, at 3-4 (filed Oct. 4, 2010) (Net56 Appeal FY 2008).

²⁰ See Request for Review by Net56, Inc. of Decision of the Universal Service Administrator; Harrison School District 36, 2007 Funding Year, FRNs 1531745, 1531757, 1531771, 1531783, 1531795, at 2 & Exhibit E (filed May 23, 2011) (Net56 Appeal FY 2007) (stating that for FY 2007, Harrison and Net56 entered into a contract on January 10, 2007, after which Harrison posted its FCC Form 471 on January 22, 2007); Net56 Appeal FY 2008 at 3 (stating that for FY 2008, Harrison and Net56 entered into a contract on February 3, 2008, and Harrison posted its FCC Form 471 on February 7, 2008); Request for Review by Net56, Inc. of Decision of the Universal Service Administrator; Harrison School District 36, 2009 Funding Year, FRNs 1852702, 1852749, 1852785, 1852800, at 3 (filed Dec. 22, 2010) (Net56 Appeal FY 2009) (stating that for FY 2009, Harrison and Net56 entered into a contract on February 3, 2009, and Harrison posted its FCC Form 471 on February 11, 2009).

²¹ See Net56 Appeal FY 2007 at 2-7; Net56 Appeal FY 2008 at 3-7; Net56 Appeal FY 2009 at 3-7.

²² See *supra* n. 20.

²³ See Net56 Appeal FY 2007 at Exhibit G (explaining that Harrison was responsible for \$4859.50 for E-rate Services and \$1,577.40 for other non-E-rate Services for FY 2007); Net56 Appeal FY 2009 at Attachment 4 (explaining that Harrison was responsible for \$4859.50 for E-rate Services and \$1,447.40 for other non-E-rate Services for FY 2009); Letter from Paul Hudson, Counsel to Net56, Inc., to Mel Blackwell, Vice President of the Schools and Libraries Division, USAC, at 11 (dated Feb. 19, 2010) (explaining that Harrison was responsible for \$4859.50 for E-rate Services and \$1,447.40 for other non-E-rate Services for FY 2008).

²⁴ See 47 C.F.R. 54.504(a)(1)(iii) (2012). See also 47 C.F.R. § 54.504 (c)(1)(iii) (2007).

²⁵ See Harrison FY 2007 Commitment Adjustment Letter at 4, 7, 8, 10, 12; FY 2008 Further Explanation of Administrator's Funding Decision at 6-8; FY 2009 Further Explanation of Administrator's Funding Decision at 6-8.

²⁶ See e.g., Harrison FY 2007 Commitment Adjustment Letter at 4.

²⁷ See Net56 Appeal FY 2007 at 6-7; Net56 Appeal FY 2008 at 5-7; Net56 Appeal FY 2009 at 5-7.

rate eligible services.²⁸ Net56 also states that it sought and received approval from USAC to use financiers, such as ACFS, to accept payments from applicants.²⁹

9. After reviewing the record, we find that Harrison and Net56's contracts required Harrison to pay ACFS for eligible and ineligible services and goods.³⁰ Pursuant to a contract between Harrison and ACFS, ACFS would then remit part of Harrison's payment to Net56 for the eligible services.³¹ Because the record reflects this process for payment continued through funding years 2007 through 2009,³² we find that Harrison did pay its share for E-rate supported services in accordance with Commission rules. USAC's determination that Harrison accepted free services was premised on its allegation that Harrison did not pay its share for those services. Because we find that Harrison paid its share for the services at issue, we find that Harrison did not receive any free services.

10. USAC also determined that certain services requested by Harrison in its requests for WAN, firewall services, and email and web hosting services were ineligible for funding.³³ In its appeals, Net56 does not appeal USAC's eligibility determinations and instead asks that Harrison receive funding in the amounts deemed appropriate by USAC during its cost effectiveness review.³⁴ Because Net56 does not contest USAC's determinations with respect to eligibility of these services, we will not address them here.

²⁸ See *supra* n. 27.

²⁹ Letter from Paul B. Hudson, Counsel to Net56, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission at 1 (dated Aug. 15, 2011) ("Net56 . . . walked away from those discussions [with USAC] believing that it had been given a go-ahead"). "I spoke with the USAC Ombudsman tonight and he said that it does not matter if you have the lease or the lease is assigned . . . Net56 can bill for services as is." *Id.* at Attachment 2.

³⁰ See Harrison School District 36 – Net56 Master Service Agreement and Master Lease Agreement at 1 (dated June 21, 2007).

³¹ See e.g., Net56 Appeal FY 2009 at Exhibit C, Attachment 3; see also Invoice from ACFS to Harrison School District 36 for Services Rendered by Net56 (dated July 1, 2007) (requesting a payment of \$7,377.25).

³² See Letter from Paul B. Hudson, Counsel to Net56, Inc., to Anita Patankar-Stoll, Attorney-Advisor, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission at Exhibit 2 (dated May 31, 2012).

³³ See Harrison FY 2007 Commitment Adjustment Letter at 4 (listing the following services as ineligible for funding: "Maintenance, operation and repair of co-located equipment (customer equipment located at the Net56 data center), phone support of standard Microsoft applications running on co-located equipment, monitor 7 x 24 of co-located equipment, provide anti-virus services on co-located equipment and maintain and deploy anti-virus at desktop, Tier 1 help desk, onsite support to the desktop, on-site floating field engineer, redesign of District web site, Tier 1 & 2 help desk support, business continuity plan, application hosting services, application support for accounting and student information systems, SharePoint portal services, unlimited professional development on Microsoft Office and other applications"). USAC listed a DNS/DHCP server as being misclassified as eligible for priority 1 funding instead of priority 2 funding. *Id.* at 6. Finally, USAC found that Harrison asked for a firewall at the Net56 data center, which was an ineligible location, and for e-mail and web retention and journaling, which were also ineligible for funding. *Id.* at 8, 10, 12. See also FY 2008 Further Explanation of Administrator's Funding Decision at 1-4; FY 2009 Further Explanation of Administrator's Funding Decision at 1-4.

³⁴ See Net56 Appeal FY 2008 at 7-9; Net56 Appeal FY 2009 at 7-9. "Net56 is simply asking to be able to receive at least a fraction of the contract price for a service that no one denies has already been provided in full." *Id.* at 8. See also Letter from Paul B. Hudson, Counsel to Net56, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission at 2 (dated Jul. 31, 2012) (Net56 July 31, 2012 Letter) ("Net56 notes that it is not seeking funding for certain functions that had been included in the contract prices but that USAC held were ineligible").

11. Finally, we address USAC's determination that Harrison's funding requests for WAN services, firewall services, and email and web hosting services ~~were not cost effective.~~³⁵ Applicants are required to request discounts based on their reasonable needs and resources and their bids for services should be evaluated based on cost-effectiveness.³⁶ ~~In the instant matter, Net56 describes its service to Harrison, as well as other school districts and commercial clients, as a centralized solution that housed most of the equipment at the Net56 location, rather than on Harrison's premises.³⁷ For firewall services, Net56 provided a "robust and reliable" solution that used a specific switch and firewall software for all of its applicants.³⁸ For WAN services, Net56 explained that its pricing varied per applicant depending on how many routers were needed and bandwidth requirements, and that Harrison had one router on its location to send and receive Internet services.³⁹ For email and web hosting services, Net56 explained that it used a "network-based architecture" and provided costs associated with the equipment needed for these services.⁴⁰~~

12. USAC determined that Net56's services for WAN, firewall services, and email and web hosting services, "exceed[ed] twice the cost of a commercially available solution" and were therefore, not cost effective.⁴¹ USAC used a five-year contract between Harrison and Net56 and calculated costs based on that length of time.⁴² USAC argued that Harrison could have purchased equipment for school premises for significantly less than the leased option provided by Net56.⁴³ To arrive at its cost estimates for the commercially available solution, USAC conducted web searches for the purchase prices of specific network equipment and added an additional fifty percent of that price to estimate charges for installation and annual maintenance.⁴⁴ ~~Net56 argues that USAC's solution for Harrison severely understates the costs associated with a premises-based solution.⁴⁵ For example, Net56 argues that USAC's estimate of the cost to obtain a commercially available solution fails to include costs for licenses, load balancers, additional bandwidth, obsolete equipment, hiring personnel, and training personnel to~~

³⁵ See FY 2008 Further Explanation of Administrator's Funding Decision at 3 (concluding that Net56's WAN solution cost \$35,400 over the course of a five year contract, whereas USAC's theoretical premises-based solution would cost \$7,200). For firewall services over five years, according to USAC, Net56's solution would cost \$69,000, whereas USAC's theoretical premises-based solution would cost \$20,000. *Id.* at 3-4. Also, for web hosting and e-mail services, USAC claims that Net56's solution would cost \$240,000 over the course of five years, whereas USAC's theoretical premises-based solution would cost \$57,000. *Id.* at 4. See also Harrison FY 2007 Commitment Adjustment Letter at 6-12; FY 2009 Further Explanation of Administrator's Funding Decision at 3-4.

³⁶ See *supra* n. 1.

³⁷ See Net56 July 31, 2012 Letter at 1-4; Email from Paul B. Hudson, Counsel to Net56, Inc., to Anita Patankar-Stoll, Attorney-Advisor, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission (dated Sept. 13, 2012).

³⁸ See Net56 July 31, 2012 Letter at 3.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ See, Harrison FY 2007 Commitment Adjustment Letter at 7. See also *supra* n. 34.

⁴² See FY 2008 Further Explanation of Administrator's Funding Decision at 3-4 (using the Harrison School District 36 – Net56 Master Service Agreement and Master Lease Agreement, which was signed June 21, 2007).

⁴³ See *e.g.*, FY 2008 Further Explanation of Administrator's Funding Decision at 3-4. See also *supra* n. 34.

⁴⁴ See *e.g.*, FY 2008 Further Explanation of Administrator's Funding Decision at 3-4.

⁴⁵ See Email from Paul B. Hudson, Counsel to Net56, Inc., to Anita Patankar-Stoll, Attorney-Advisor, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission (dated Sept. 13, 2012).

operate, monitor and maintain purchased equipment.⁴⁶ Net56 argues that USAC's estimated price for the requested services would have been more expensive, and that Net56's leased solution is much more cost effective for Harrison.⁴⁷ Additionally, Net56 states that USAC used the wrong contract and should not have been projecting costs for five years and instead, USAC should have considered the E-rate one-year contracts.⁴⁸ With respect to USAC's finding that the installation and maintenance costs it charged Harrison were excessive, Net56 argues that it used formulas given by USAC to determine installation and maintenance costs.⁴⁹ Therefore, Net56 argues that the prices for services and products to Harrison were cost effective.⁵⁰

13. The Commission has not established a bright line test for determining when costs for services are excessive.⁵¹ The Commission has, however, noted that there may be instances where costs for services are so exorbitant that they cannot be cost effective and gave the example of a router that is sold for two to three times the commercial market price.⁵² Based on the information before us, that is not the case here, as the services requested by Harrison were not two to three times the estimated commercial market price.

14. In this case, we find, first, that the record supports a determination that Harrison followed the Commission's rules in conducting its bidding and selection process.⁵³ In all three funding years, Net56 was the only bidder to respond to Harrison's FCC Form 470.⁵⁴ Thus, necessarily, Net56's bid offered the lowest price.⁵⁵ Second, we are not persuaded that USAC took into account all the relevant costs when estimating the cost of a premises-based solution for Harrison compared to Net56's leased solution for Harrison. Third, the record reflects that Net56 complied with the Commission's rules regarding lowest corresponding price, which requires service providers to provide applicants with prices no higher than the lowest price that it charges to similarly-situated non-residential customer for similar services.⁵⁶ Net56 provided examples of prices for its commercial customers for Internet access, wide area network, web and email hosting, and firewall services and compared them to the lower prices that it

⁴⁶ See *id.*

⁴⁷ See Net56 July 31, 2012 Letter at 3.

⁴⁸ See *id.*

⁴⁹ See *id.* at 2.

⁵⁰ See Net56 July 31, 2012 Letter at 2.

⁵¹ See *Ysleta*, 18 FCC Rcd at 26432, para. 54 ("The Commission has not, to date, enunciated bright-line standards for determining when particular services are priced so high as to be considered not cost-effective under our rules.")

⁵² See *id.*

⁵³ See *supra* n. 16.

⁵⁴ See Email from Paul B. Hudson, Counsel to Net56, Inc., to Anita Patankar-Stoll, Attorney-Advisor, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission (dated May 21, 2012).

⁵⁵ See *Allendale*, 26 FCC Rcd at 6115-16.

⁵⁶ See 47 C.F.R. § 54.511(b) (2007) ("Providers of eligible services shall not charge schools, school district, libraries, library consortia, or consortia including any of these entities a price above the lowest corresponding price for supported services, unless the Commission, with respect to interstate services or the state commission with respect to intrastate services, finds that the lowest corresponding prices is not compensatory. Promotional rates offered by a service provider for a period of more than 90 days must be included among the comparable rates upon which the lowest corresponding price is determined."); see also *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourth Order on Reconsideration, 13 FCC Rcd 2372, para. 133 (1997).

charged to Harrison.⁵⁷ Based on all of these factors, we conclude that USAC did not establish that Harrison failed to select a cost-effective service.

15. Lastly, on our own motion, we waive section 54.507(d) of the Commission's rules and direct USAC to waive any procedural deadline, such as the invoicing deadline, that might be necessary to effectuate our ruling.⁵⁸ We find good cause to waive section 54.507(d) because filing an appeal of a denial is likely to cause the applicant to miss the program's subsequent procedural deadlines in that funding year.

16. Therefore based on our review of the record, we grant the requests of Net56 with respect to Harrison's funding year 2007 through 2009 E-rate applications. On remand, we direct USAC to process the grant using the services and pricing found in Harrison's E-rate contracts dated January 1, 2007, February 3, 2008, and February 3, 2009, and reduce the funding request by the amount of any ineligible charges consistent with this order. To ensure that the underlying applications are resolved expeditiously, we direct USAC to complete its review of each application listed in the appendix and issue an award or a denial based on a complete review and analysis no later than 90 calendar days from the release date of this order. In remanding these applications to USAC, we make no finding as to the ultimate eligibility of the services or the underlying applications. We direct USAC to discontinue recovery actions relating to requests for review that are addressed herein. At this time, we find that there is also no evidence of waste, fraud or abuse, in the record.

17. ACCORDINGLY, IT IS ORDERED, pursuant to the authority contained in sections 1-4 and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154 and 254, and sections 0.91, 0.291, 1.3 and 54.722(a) of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.3 and 54.722(a), the requests for review filed by Net56, Inc. as listed in the Appendix ARE GRANTED and the underlying applications ARE REMANDED to USAC for further consideration in accordance with the terms of this order.

18. IT IS FURTHER ORDERED, pursuant to the authority contained in sections 1-4 and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154 and 254, and sections 0.91, 0.291, 1.3 and 54.722(a) of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.3 and 54.722(a), that section 54.507(d) of the Commission's rules, 47 C.F.R. § 54.507(d), IS WAIVED for the parties to the limited extent provided herein.

FEDERAL COMMUNICATIONS COMMISSION

Trent B. Harkrader
Chief
Telecommunications Access Policy Division
Wireline Competition Bureau

⁵⁷ See Net56 July 31, 2012 Letter at 4-5.

⁵⁸ 47 C.F.R. § 54.507(d) (2012) (requiring non-recurring services to be implemented by September 30 following the close of the funding year).

APPENDIX

Petitioner	Application Number	Funding Year	Date Request for Review Filed
Net56, Inc.	552545	2007	May 23, 2011
Palatine, Illinois	634059	2008	Oct. 4, 2010
(Harrison School District 36, Wonderlake, Illinois)	678493	2009	Dec. 22, 2010

1

2

3

4

5

Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of)	
)	
Requests for Review of)	
Decisions of the)	
Universal Service Administrator by)	
)	
Net56, Inc.)	File No. SLD-678753
Palatine, IL)	
)	
Schools and Libraries Universal Service)	CC Docket No. 02-6
Support Mechanism)	

ORDER

Adopted: December 19, 2012**Released: December 19, 2012**

By the Chief, Telecommunications Access Policy Division, Wireline Competition Bureau:

1. Consistent with precedent,¹ we grant a request from Net56, Inc. (Net56) seeking review of a decision by the Universal Service Administrative Company (USAC) under the E-rate program (more formally known as the schools and libraries universal service support program) to deny funding for Country Club Hills School District 160's (Country Club Hills) application for funding year 2009.² In this appeal, we find USAC erred in finding that the applicant violated the Commission's rules when selecting Net56 to provide Internet access, wide area network (WAN), firewall, and web and email hosting services.³

¹ See *Request for Review of Decisions of the Universal Service Administrator by Net56, Inc.*, CC Docket No. 02-6, Order, 27 FCC Rcd 13606 (Wireline Comp. Bur. 2012) (*Net56/Harrison*) (finding that the applicant cost allocated E-rate eligible services, paid its non-discounted share for services, and selected cost-effective services, *inter alia*); *Request for Review of Decisions of the Universal Service Administrator by Net56, Inc.*, CC Docket No. 02-6, Order, DA 12-1951 (Wireline Comp. Bur. rel. Dec. 4, 2012) (*Net56/Posen-Robbins*). See also, e.g., *Request for Review by Ysleta Independent School District of the Decision of the Universal Service Administrator*, CC Docket Nos. 96-45, 97-21, Order, 18 FCC Rcd 26407, 26431, para. 53 (2003) (*Ysleta*) ("The Commission has determined that seeking competitive bids for eligible services is the most efficient means for ensuring that eligible schools and libraries are fully informed of their choices and are most likely to receive cost-effective services"); *Request for Review by Macomb Intermediate School District Technology Consortium of the Decision of the Universal Service Administrator*, CC Docket No. 02-6, Order, 22 FCC Rcd 8771, 8772, para. 2 (2007) (applicants must select the most cost-effective service offering).

² See *Request for Review by Net56, Inc. of Decision of the Universal Service Administrator, Country Club Hills School District, 2009 Funding Year*, funding request numbers (FRNs) 1853415, 1853424, 1853437, at 4 (filed Aug. 30, 2010) (*Net56 Appeal FY 2009*). Section 54.719(c) of the Commission's rules provides that any person aggrieved by an action taken by a division of USAC may seek review from the Commission. 47 C.F.R. § 54.719(c) (2012).

³ See *Net56/Harrison*, 27 FCC Rcd at 13612, para. 14; *Net56/Posen-Robbins* at para. 9. See also Letter from USAC, Schools and Libraries Division, to Net56, Inc. (dated Feb. 23, 2010) (regarding Country Club Hills's funding year (FY) 2009 FCC Form 471 application number 678753, FRNs 1853415, 1853424, and 1853437) (Country Club Hills FY 2009 Funding Commitment Decision Letter (FCDL) (denying funds for FY 2009); Letter from USAC, Schools

(continued...)

2. As with the two previous appeals involving Net56, we find that USAC erred in its determination that the applicant, in this case Country Club Hills, violated the Commission's rules by failing to cost allocate services in its contract with Net56, failing to pay its discounted share for eligible services,⁴ and failing to select cost-effective eligible services.⁵ In this instance, on appeal, USAC also found that Country Club Hills failed to retain documentation regarding its competitive bidding process.⁶ We also grant Net56's appeal of that determination. As with the two previous appeals involving Net56, we find USAC incorrectly considered a five-year Master Services Agreement (MSA) between Net56 and the applicant, rather than the existing one-year contract for E-rate services.⁷

3. We find that USAC considered the wrong contract in deciding to deny funding to Country Club Hills for funding year 2009. The record shows that Country Club Hills did have an E-rate contract with Net56 which allocated eligible from ineligible services.⁸ The record also demonstrates that Country Club Hills paid its share of the non-discounted portion of the eligible services, in accordance with the one-year E-rate contract.⁹ As with the other Net56-related appeals, Net56 explains that it used a financial company, Millennium Leasing & Financial Services, Inc. ("Millennium"), to facilitate payments from Country Club Hills to Net56 for E-rate eligible services.¹⁰ The record shows that Country Club Hills was required to pay Millennium for eligible and ineligible services and goods.¹¹ Millennium would then remit Country Club Hills's non-discount portion of the cost of the eligible goods and services to Net56 for the E-rate eligible services.¹² Because this payment process was in effect for funding year 2009, we find that Country Club Hills did pay its share for E-rate supported services in accordance with Commission rules.

4. USAC also determined that certain services requested by Country Club Hills in its requests for WAN, firewall, email, and web hosting services were ineligible for funding.¹³ In its appeals, Net56

(Continued from previous page) _____
and Libraries Division, to Denise Peeks, Country Club Hills School District 160 (dated March 26, 2010) (FY 2009 Further Explanation of Administrator's Funding Decision). Subsequently, USAC also denied Net56's appeal of Country Club Hills's funding year 2009 denials. *See* Letter from USAC, Schools and Libraries Division, to Paul B. Hudson, Counsel to Net56, Inc. (dated Jun. 29, 2010) (Administrator's Decision on Appeal – Funding Year 2009-2010).

⁴ *See* FY 2009 Further Explanation of Administrator's Funding Decision at 4-7.

⁵ *See id.* at 3.

⁶ *See* Administrator's Decision on Appeal – Funding Year 2009-2010 at 2.

⁷ *See* FY 2009 Further Explanation of Administrator's Funding Decision at 4-7. Because it considered the MSA to be the contract for E-rate services between Country Club Hills and Net56, it also found that Country Club Hills and Net56 failed to allocate costs between eligible and ineligible services and that Country Club Hills did not pay its share of the E-rate supported services.

⁸ *See* Net56 Appeal FY 2009 at 7 and Ex. C at Attachments 2-4.

⁹ *See id.* at Attachments 2-3.

¹⁰ *See id.* at 7 and Ex. C at Attachment 3.

¹¹ *See* Net56 Appeal FY 2009 at Ex. C at Attachment 3.

¹² *See id.*

¹³ *See* FY 2009 Further Explanation of Administrator's Funding Decision at 4 (listing the following services as ineligible for funding: "maintenance and repair of school owned equipment located in the Net56 datacenter (co-located equipment), backup of hard drives of co-located equipment, providing anti-virus services on co-located equipment, providing environmentally controlled atmosphere and generated backup power for co-located equipment"). USAC found that a DNS/DHCP server that Country Club Hills included in its priority 1 funding request should have been requested in a priority 2 funding request. *Id.* at 2. USAC also found that Country Club Hills asked for a firewall at the Net56 data center, an ineligible location, and for e-mail and web retention and journaling, which were also ineligible for funding. *Id.* at 1-3.

does not appeal USAC's eligibility determinations about certain of the services at issue.¹⁴ Because Net56 does not contest USAC's determinations with respect to eligibility of these services, we will not address them here.

5. Next we address USAC's determination that Country Club Hills's funding requests for email and web hosting services were not cost effective.¹⁵ Applicants are required to request discounts based on their reasonable needs and resources and their bids for services should be evaluated based on cost-effectiveness.¹⁶ In the instant matter, as in the other Net56-related appeals, USAC determined that Net56's services for email and web hosting services "exceed[ed] twice the cost of a commercially available solution" and were therefore not cost effective.¹⁷ As we have previously explained, the Commission has not established a bright line test for determining when costs for services are excessive.¹⁸ The Commission has, however, noted that there may be instances where costs for prices or services are so exorbitant that they cannot be cost effective and gave the example of a router that is sold for two to three times the commercial market price.¹⁹ Here, we are not persuaded that USAC took into account all the relevant costs when estimating the cost of a premises-based solution compared to Net56's leased solution for Country Club Hills. Based on the record before us, we conclude that the services requested by Country Club Hills were not two to three times the estimated commercial market price.

6. Moreover, as with the previous Net56 related cases, we find that the record supports a determination that Country Club Hills followed the Commission's rules in conducting its bidding and selection process.²⁰ The record also reflects that Net56 complied with the Commission's rules regarding lowest corresponding price, which requires service providers to provide applicants with prices no higher than the lowest price that it charges to similarly-situated non-residential customers for similar services.²¹ Net56 provided examples of prices for its commercial customers for web and email hosting services and

¹⁴ See Net56 Appeal FY 2009 at 7-9. See also Letter from Paul B. Hudson, Counsel to Net56, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission at 2 (dated Jul. 31, 2012) (Net56 July 31, 2012 Letter)

¹⁵ See FY 2009 Further Explanation of Administrator's Funding Decision at 3 (concluding that Net56's web hosting and email solution cost \$480,000 over the course of a five-year contract, whereas USAC's theoretical premises-based solution would cost \$57,000). USAC did not undertake a cost-effectiveness review for Net56's prices for Internet access or firewall services. *Id.* at 2.

¹⁶ See *supra* n.1.

¹⁷ See FY 2009 Further Explanation of Administrator's Funding Decision at 3.

¹⁸ See *Ysleta*, 18 FCC Rcd at 26432, para. 54 ("The Commission has not, to date, enunciated bright-line standards for determining when particular services are priced so high as to be considered not cost-effective under our rules").

¹⁹ See *id.*

²⁰ See 47 C.F.R. § 54.503 (2012) (requiring applicants to seek competitive bids to procure E-rate services and providing instruction on the protocol for the bidding process). See also 47 C.F.R. § 54.504 (2009). See, e.g., FCC Form 470, Country Club Hills School District 160 (posted Dec. 15, 2008); Letter from Denise O. Peeks, Business Manager, Country Club Hills School District 160 to Marlene H. Dortch, Secretary, Federal Communications Commission at 1 (dated Mar. 2, 2011).

²¹ See 47 C.F.R. § 54.511(b) (2012). See also 47 C.F.R. § 54.511(b) (2009) ("Providers of eligible services shall not charge schools, school districts, libraries, library consortia, or consortia including any of these entities a price above the lowest corresponding price for supported services, unless the Commission, with respect to interstate services or the state commission with respect to intrastate services, finds that the lowest corresponding price is not compensatory. Promotional rates offered by a service provider for a period of more than 90 days must be included among the comparable rates upon which the lowest corresponding price is determined."). See also *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourth Order on Reconsideration, 13 FCC Rcd 5318, 5398, para. 133 (1997).

compared them to the comparable prices that it charged to Country Club Hills.²² Based on these factors and the record before us, we conclude that USAC erred in finding that the services Country Club Hills purchased were not cost effective.²³

7. Finally, we address USAC's allegation that Country Club Hills failed to retain required competitive bidding documents. Here, it is undisputed that Net56 was the only bidder, and the record demonstrates that Country Club Hills retained all necessary documents relating to Net56's bid. Therefore, we find that USAC erred in finding that Country Club Hills failed to retain required documentation.

8. Lastly, on our own motion, we waive section 54.507(d) of the Commission's rules and direct USAC to waive any procedural deadline, such as the invoicing deadline, that might be necessary to effectuate our ruling.²⁴ We find good cause to waive section 54.507(d) because filing an appeal of a denial is likely to cause the applicant to miss the program's subsequent procedural deadlines in that funding year.

9. Therefore based on our review of the record, we grant the request of Net56 with respect to Country Club Hills's funding year 2009 E-rate application. On remand, we direct USAC to process the grant using the services and pricing found in Country Club Hills's E-rate contract dated January 20, 2009, and reduce the funding request by the amount of any ineligible charges consistent with this order. To ensure that the underlying applications are resolved expeditiously, we direct USAC to complete its review of each application listed in the appendix and issue an award or a denial based on a complete review and analysis no later than 90 calendar days from the release date of this order. In remanding these applications to USAC, we make no finding as to the ultimate eligibility of the services or the underlying applications. We direct USAC to discontinue recovery actions relating to requests for review that are addressed herein. At this time, we also find that there is no evidence of waste, fraud or abuse in the record.

10. ACCORDINGLY, IT IS ORDERED, pursuant to the authority contained in sections 1-4 and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154 and 254, and sections 0.91, 0.291, 1.3 and 54.722(a) of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.3 and 54.722(a), that the request for review filed by Net56, Inc. IS GRANTED and the underlying application IS REMANDED to USAC for further consideration in accordance with the terms of this order.

²² See Net56 July 31, 2012 Letter at 4-5.

²³ See, e.g., *Net56/Harrison*, 27 FCC Rcd at 13612, para. 14 (explaining how Net56 demonstrated that its costs for products and services were not unreasonable based on the needs and circumstances of Harrison School District 36 and that USAC erred in finding that the services were not cost-effective).

²⁴ 47 C.F.R. § 54.507(d) (2012) (requiring non-recurring services to be implemented by September 30 following the close of the funding year).

11. IT IS FURTHER ORDERED, pursuant to the authority contained in sections 1-4 and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154 and 254, and sections 0.91, 0.291, 1.3 and 54.722(a) of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.3 and 54.722(a), that section 54.507(d) of the Commission's rules, 47 C.F.R. § 54.507(d), IS WAIVED for the parties to the limited extent provided herein.

FEDERAL COMMUNICATIONS COMMISSION

Trent B. Harkrader
Chief
Telecommunications Access Policy Division
Wireline Competition Bureau



Universal Service Administrative Company

Schools and Libraries Division

February 2, 2010

Tony DeMonte
Zion School District 6
2200 Bethesda Blvd
Zion, IL 60099-2352

Further Explanation of Administrator's Funding Decision
FCC Form 471 Application Number: 634543
Funding Request Numbers: 1755454, 1755495 and 1755527
Funding Year 2008 (07/01/2008 – 06/30/2009)
Billed Entity Number: 135356

Under separate cover, you are being sent a Funding Commitment Decision Letter concerning the FCC Form 471 Application Number cited above. This Funding Commitment Decision Letter denies the Funding Request Number(s) indicated above.

Please be advised that the Funding Commitment Decision Letter (FCDL) is the official action on this application by the Universal Service Administrative Company (USAC). Please refer to that letter for instructions regarding how to appeal the Administrator's decision, if you wish to do so. The purpose of this letter is to provide you with additional information concerning the reason for modification and denial of these funding requests.

Review of FRN #1755454

FRN #1755454 requests funding in the amount of \$90,780 for Internet access WAN service. This WAN service request includes on-premise equipment. According to the Item 21 attachments and additional documentation you provided on November 20, 2008, which included a more detailed description of the services being procured from Net56 and a network diagram, the on-premise equipment consisted of Cisco 3560 series layer 3, Gb Switch/Routers and IBM Series 3200 Servers, which were to function as DNS/DHCP servers.

Based on a review of the network diagram and related documentation related to this on-premise equipment, in accordance with the requirements of the Tennessee Order (FCC 99-216), the WAN servers, identified as DNS/DHCP servers, are not eligible as part of a Priority 1 Internet access service.

Ms. Tony DeMonte
February 2, 2010
Page 2 of 7

The Tennessee Order questions address the exclusive use of the servers, and whether the DHCP service would function if the servers were removed. For reference, please see <http://www.usac.org/sl/applicants/step06/on-premise-priority1-equipment.aspx>.

- The diagram configuration, and the function of the servers, fail the following requirements of the Tennessee Order:
 - *The Local Area Network of the school or library is functional without dependence on the equipment.* This is because the DHCP/DNS service would not be able to function if the servers were removed.
 - *There is no contractual, technical, or other limitation that would prevent the service provider from using its network equipment, in part, for other customers.* This is because the servers are located at an applicant site; as such, it would not be possible for the vendor to utilize the same servers to provide DNS/DHCP service to another customer.

While the WAN servers could potentially be eligible as Priority 2 internal connections, your establishing FCC Form 470, #112010000655298, did not post for Internal Connections. Therefore, these servers are not fundable as Internal Connections.

In response to USAC's request for cost allocation information, your service provider, Net56, in their response dated February 22, 2009, indicated that the cost associated with the servers was \$205 per month each or a total of \$17,220 annually. Your funding request was reduced by that amount.

After modification and removal of the costs associated with the ineligible servers, this FRN was subjected to a cost effectiveness review by USAC. This review was conducted based on the Item 21 attachments, related follow up questions and your responses to those follow up questions. This cost effectiveness review compared the funding requested for the solution from Net56 with the funding required for a comparable premises-based solution, as well as other on-premises solutions.

The result of that review was that the funding request was not justified as cost effective as required by FCC rules. Specifically, the Internet access WAN services exceed two times the cost of a comparable solution from commercial vendors for the eligible services. The FCC has stated that in some situations in which "the price of services is so exorbitant that it cannot, on its face be cost effective" and cited as an example selling a service "at prices two to three times greater than the prices available from commercial vendors would not be cost effective, absent extenuating services" *Ysleta Order*, FCC 03-313, paragraph 54.¹ The funding required for the Net56 solution over the five year life of the contract is \$367,800. However, the cost of a comparable solution that is based on purchasing the networking equipment and annual maintenance would be approximately \$58,000. This

¹ See 47 C.F.R. secs. 54.511(a), 54.504(b)(2)(vii), 54.504(c)(1)(xi). See also Request for Review of the Decision of the Universal Service Administrator by Ysleta Independent School District, et al., CC Docket Nos. 96-45 and 97-21, Order, 18 FCC Rcd 26407, FCC 03-313 paras. 47-55 (Dec. 8, 2003) (*Ysleta Order*).

Ms. Tony DeMonte
February 2, 2010
Page 3 of 7

amount accounts for the purchase of seven routers at market price of \$2100 each, plus 50 percent of that cost for installation and configuration, plus 50 percent of that cost annually for maintenance.

FRN #1755495 Review

FRN #1755495 requests funding in the amount of \$65,580 for a firewall service. This firewall service includes on-premise software running on the switch included in the WAN service FRN #1755454. FRN #1755495 also includes firewall equipment located at the Net56 data center. The Net56 data center is an ineligible location; accordingly, equipment located there is ineligible for funding. Also, since the funding request includes the firewall capability of the software running on the switch, which is located at the point of entry of each building, it has been determined that the equipment located at the Net56 data center is redundant and therefore ineligible for that reason as well.

In response to USAC's request for cost allocation information, your service provider, Net56, in their response dated February 22, 2009, indicated that the cost associated with the firewall equipment located at the Net56 data center was \$1,350 per month or \$16,200 annually. The funding request was reduced by that amount.

After modification and removal of the costs associated with the firewall equipment located at the Net56 data center, this FRN was subjected to a cost effectiveness review by USAC. This review was conducted based on the Item 21 attachments, related follow up questions and your responses to those follow up questions. This cost effectiveness review compared the funding requested for the solution from Net56 with the funding required for a comparable premises-based solution, as well as other on-premises solutions.

The result of that review was that the funding request was not justified as cost effective as required by FCC rules. The FCC has stated that in some situations in which "the price of services is so exorbitant that it cannot, on its face be cost effective" and cited as an example selling a service "at prices two to three times greater than the prices available from commercial vendors would not be cost effective, absent extenuating services" Ysleta Order, FCC 03-313, paragraph 54.² Specifically, the Internet access firewall approaches two times the cost of a comparable solution from commercial vendors. The funding required for the Net56 solution over the five year life of the contract is \$246,900. However, the cost of a comparable solution that is based on purchasing firewall equipment for each of the seven locations and annual maintenance would be approximately \$140,000. This amount accounts for the purchase of seven Cisco PIX Firewall devices at market price of \$5,000 each, plus 50 percent of that cost for installation and configuration, plus 50 percent of that cost annually for maintenance.

² See *id*

Ms. Tony DeMonte
February 2, 2010
Page 4 of 7

FRN #1755527 Review

FRN #1755527 requests funding in the amount of \$60,000 for web hosting and email services. In the response to USAC's information request regarding the specific services included in this funding request, you indicated that these services include web retention and web journaling as well as email retention and email journaling. Web retention and e-mail retention is archiving of information. Web journaling and e-mail journaling is an application. These products/services are ineligible under program rules.

For details, please refer to the Eligible Services List:

<http://www.universalservice.org/sl/tools/eligible-services-list.aspx>.

In response to USAC's request for cost allocation information, your service provider, Net56, in their response dated February 22, 2009, indicated that the cost associated with the email retention and journaling and web retention and journaling was \$1,000 per month or \$12,000 annually. The funding request was reduced by that amount.

After modification and removal of the costs associated with the email retention and journaling and the web retention and journaling, this FRN was subjected to a cost effectiveness review by USAC. This review was conducted based on the Item 21 attachments and follow up questions and your responses to the follow up questions. This cost effectiveness review compared the funding requested for the solution from Net56 with the funding required for a comparable premises-based solution, as well as other on-premises solutions.

The result of that review was that the funding request was not justified as cost effective as required by FCC rules. The FCC has stated that in some situations in which "the price of services is so exorbitant that it cannot, on its face be cost effective" and cited as an example selling a service "at prices two to three times greater than the prices available from commercial vendors would not be cost effective, absent extenuating services" Ysleta Order, FCC 03-313, paragraph 54.³ Specifically, the Internet access firewall services exceed two times the cost of a comparable solution from commercial vendors. The funding required for the Net56 solution over the five year life of the contract is \$240,000. However, the cost of a comparable solution that is based on purchasing the server equipment and annual maintenance would be approximately \$57,000. This amount accounts for the purchase of four servers at a market price of \$14,000, including installation and maintenance for five years. It should be noted that in most cases, two servers are adequate to perform these functions. Costs associated with the purchase of two servers would be approximately \$28,500.

³ See *id*

Ms. Tony DeMonte
February 2, 2010
Page 5 of 7

Contract Review: Service Eligibility Issues

In response to the April 13, 2009 request by USAC for all contracts between the Zion School District 6 and the service provider, Net56, the applicant provided one contract. The contract is signed by Ruth A. Davis, President of the school board and dated February 27, 2006. It is for a term of 60 months.

Upon review, your contract specifies several additional ineligible services that are included in the funding requests beyond what was disclosed in your responses to information requests. Such services include, but are not limited to, the following: maintenance, operation and repair of school owned equipment located in the Net56 data center (co-located equipment), providing anti-virus services on co-located equipment, providing environmentally controlled atmosphere and generated backup power for co-located equipment.

Because the FRNs had already been determined to be not cost effective based on the information that was previously provided, USAC did not attempt to re-perform cost allocations and the cost effectiveness reviews based upon this additional information, and the previous determinations as detailed above stand.

However, it is important to note that during the course of this review, both you and your service provider failed to provide a breakdown of the eligible versus ineligible services being received from Net56 and their respective dollar amounts that is consistent with the services and costs noted in your contract, which, additionally, tie in clearly to your Schools and Libraries Program funding requests. As explained in greater detail below, the documentation provided by you indicates that the monthly payments are exclusively for the rental/lease of equipment that is not fundable because it is located at an ineligible entity.

Contract Review: Payments

The Master Service Agreement portion of the aforementioned contract, in section 3, states that this is the sole agreement between the school and the service provider "relating to the subject matter hereof." Accordingly, there is no other agreement/contract related to the services requested in FCC Form 471 application #634543.

This contract specifies a monthly payment of \$14,000 to be paid pursuant to the terms and conditions of Exhibit D, which is a financing agreement between the school and Millennium Leasing & Financial Services Inc. There is no other payment specified in the contract other than the payment to Millennium Leasing & Financial Services Inc.

Ms. Tony DeMonte
February 2, 2010
Page 6 of 7

Finance Agreement Review

The financing agreement, also signed by Ruth A. Davis, states that the school is to make 60 lease payments in the amount of \$14,000 each. The financing agreement indicates that the payments are for the rental/lease of the equipment shown in Exhibit 1 of the financing agreement. That equipment is the same equipment listed in Exhibit A of the Net56 contract. Exhibit A indicates that the implementation location of this equipment is the Net56 location at 1266 W. Northwest Hwy, Palatine, Illinois, which is an ineligible location. Per the financing agreement, the entire amount of the payments is associated with the rental/lease of this equipment.

As specified in the financing agreement between the school and the financing company, this payment is solely for the rental/lease of hardware and/or software. The hardware and/or software specified as covered by the finance agreement is ineligible because it is being deployed within the Net56 data center, which is an ineligible entity.

Although eligible services may have been provided by Net56, there is no documentation regarding any payment for eligible or ineligible Internet access services. Therefore, there is no documentation to support that you paid your Schools and Libraries Program share for any eligible Internet access services, because the lease agreement, which represents the full payment for services, is solely for the rental/lease of ineligible equipment.

Net56 Additional Information

USAC management met with several applicants as well as Net56 regarding these concerns. On October 7, 2009, Net56 provided a two page letter in response to USAC's questions. The request was to respond as to why Net56 maintained that the servers would be eligible as a Priority 1 Service; to answer how they arrived at their pricing structure; and to provide the grid referred to by some applicants that would purportedly allocate costs related to eligible and ineligible services.

The Net56 response was reviewed. First, the documentation provided did not affect the determination regarding the servers. Second, the question regarding pricing structure was not answered directly, but rather, a "Total Cost of Ownership" document was provided, which compared costs of the Net56 solution with ineligible staff costs. It is important to note that while a particular solution may lower the overall Total Cost of Ownership to an individual school district, the Schools and Libraries program can only fund eligible products and services that are used in accordance with FCC Rules, which may not always result in the lowest total cost of ownership to the applicant. Third, the grid provided, while it did pertain to the funding requests, did not serve to answer the many questions relating to disparities between the Item 21 documentation, the contract and the finance agreement.

Ms. Tony DeMonte
February 2, 2010
Page 7 of 7

Conclusion

The funding requests were reviewed for service eligibility. Ineligible services were cost allocated and the associated costs were removed from the funding requests. Cost effectiveness reviews were then performed. All three FRNs failed cost effectiveness review.

During the course of the review of these FRNs, the contract and finance agreement were provided to USAC. The services noted in the contract differ from your responses during the cost effectiveness review; however, the determination that all three FRNs fail cost effectiveness review stands, since the additional information in the contract would only lead to further cost allocations, which would still provide a cost effectiveness failure.

In regard to service eligibility of the products and services specified in your contract, no documentation was provided to USAC that clearly allocates eligible and ineligible products and services and their respective costs. As a result, it is not possible to ascertain how your Schools and Libraries Program funding requests relate to the eligible and ineligible products and services noted on the contract.

Additionally, the finance agreement, which includes the only payment related to your contract and funding requests, specifies that the payments are for the lease/rental of hardware at the Net56 data center, an ineligible location. While Net56 may be providing eligible Internet access services as a part of the contract, there is no documentation to support that any services, eligible or ineligible, are included in the payments to the finance company. Accordingly, there is no documentation regarding the payment of your Schools and Libraries Program share of Internet access services.

Finally, USAC management made additional attempts to obtain information from Net56 in regard to these concerns; however, the documentation provided did not affect the outcome of the decision.

Sincerely,

The Schools and Libraries Program

cc:
Net56
Bruce Koch
1266 W. Northwest Hwy
Suite 740
Palatine, IL 60067

000161



RECEIVED FEB 05

Schools and Libraries Division

FUNDING COMMITMENT DECISION LETTER
(Funding Year 2009: 07/01/2009 - 06/30/2010)

February 2, 2010

Mary Piazza
Net56, Inc
1266 West Northwest Hwy
Suite 740
Palatine, IL 60067

Re: Service Provider Name: Net56, Inc
Service Provider Identification Number: 143025679

Thank you for participating in the Schools and Libraries Program (Program) for Funding Year 2009. This letter is your notification of our decision(s) regarding application funding requests that listed your company's Service Provider Identification Number (SPIN).

NEXT STEPS

- File Form 498, Service Provider Information Form, if appropriate
- File Form 473, Service Provider Annual Certification Form (SPAC), for the above Funding Year
- Work with your customer to provide appropriate invoicing to USAC: Service Provider Invoice (Form 474) or Billed Entity Applicant Reimbursement (Form 472)

Please refer to the Funding Commitment Report(s) (Report) following this letter for specific funding request decisions and explanations. Each Report contains detailed information extracted from the applicant's Form 471. A guide that provides a definition for each line of the Report is available in the Reference Area of our website.

Once you have reviewed this letter, we urge you to contact your customers to establish any necessary arrangements regarding start of services, billing of discounts, and any other administrative details for implementation of discount services. As a reminder, only eligible services delivered in accordance with Federal Communications Commission (FCC) rules are eligible for these discounts.

TO APPEAL THIS DECISION:

You have the option of filing an appeal with the SLD or directly with the FCC.

If you wish to appeal a decision in this letter to USAC, your appeal must be received by USAC or postmarked within 60 days of the date of this letter. Failure to meet this requirement will result in automatic dismissal of your appeal. In your letter of appeal:

1. Include the name, address, telephone number, fax number, and (if available) email address for the person who can most readily discuss this appeal with us.
2. State outright that your letter is an appeal. Include the following to identify the decision letter and the decision you are appealing:
 - Appellant name,
 - Applicant or service provider name, if different from appellant,
 - Applicant Billed Entity Number (BEN) and Service Provider Identification Number (SPIN),
 - Form 471 Application Number as assigned by USAC,
 - "Funding Commitment Decision Letter for Funding Year 2009," AND
 - The exact text or the decision that you are appealing.

Schools and Libraries Division - Correspondence Unit,
30 Lapidex Plaza West, PO Box 685, Parsippany, NJ 07054-0685
Visit us online at: www.usac.org/sl

000162

3. Please keep your letter to the point, and provide documentation to support your appeal. Be sure to keep a copy of your entire appeal, including any correspondence and documentation.
4. If you are the applicant, please provide a copy of your appeal to the service provider(s) affected by the decision. If you are the service provider, please provide a copy of your appeal to the applicant(s) affected by USAC's decision.
5. Provide an authorized signature on your letter of appeal.

To submit your appeal to USAC by email, email to appeals@sl.universalservice.org. USAC will automatically reply to incoming emails to confirm receipt.

To submit your appeal to us by fax, fax your appeal to (973) 599-6542.

To submit your appeal to us on paper, send your appeal to:

Letter of Appeal
Schools and Libraries Division - Correspondence Unit
100 S. Jefferson Road
P.O. Box 902
Whippany, NJ 07981

If you wish to appeal a decision in this letter to the FCC, you should refer to CC Docket No. 02-6 on the first page of your appeal to the FCC. Your appeal must be received by the FCC or postmarked within 60 days of the date of this letter. Failure to meet this requirement will result in automatic dismissal of your appeal. We strongly recommend that you use the electronic filing options described in the "Appeals Procedure" posted on our website. If you are submitting your appeal via United States Postal Service, send to: FCC, Office of the Secretary, 445 12th Street SW, Washington, DC 20554.

OBLIGATION TO PAY NON-DISCOUNT PORTION

Applicants are required to pay the non-discount portion of the cost of the products and/or services to their service provider(s). Service providers are required to bill applicants for the non-discount portion. The FCC stated that requiring applicants to pay their share ensures efficiency and accountability in the program. If USAC is being billed via the FCC Form 474, the service provider must bill the applicant at the same time it bills USAC. If USAC is being billed via the FCC Form 472, the applicant pays the service provider in full (the non-discount plus discount portion) and then seeks reimbursement from USAC. If you are using a trade-in as part of your non-discount portion, please refer to our website for more information.

NOTICE ON RULES AND FUNDS AVAILABILITY

Applicants' receipt of funding commitments is contingent on their compliance with all statutory, regulatory, and procedural requirements of the Schools and Libraries Program. Applicants who have received funding commitments continue to be subject to audits and other reviews that USAC and/or the FCC may undertake periodically to assure that funds that have been committed are being used in accordance with all such requirements. USAC may be required to reduce or cancel funding commitments that were not issued in accordance with such requirements, whether due to action or inaction, including but not limited to that by USAC, the applicant, or the service provider. USAC, and other appropriate authorities (including but not limited to the FCC), may pursue enforcement actions and other means of recourse to collect improperly disbursed funds. The timing of payment of invoices may also be affected by the availability of funds based on the amount of funds collected from contributing telecommunications companies.

Schools and Libraries Division
Universal Service Administrative Company